Supreme Court, U.S.
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No. 92-87

IN THE

Supreme Court of the United States

OCTOBER TERM, 1992

In re:

KOREAG, CONTROLE ET REVISION, S.A. as Official Liquidator of MEBCO BANK, S.A. (In Liquidation) pursuant to the Insolvency Laws of the Federal Republic of Switzerland.

KOREAG, CONTROLE et REVISION, S.A.,

Petitioner,

—v.—

REFCO F/X ASSOCIATES, INC.,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

SUPPLEMENTAL AND REPLY BRIEF

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FURTHER REASONS FOR GRANTING THE WRIT

I. This Case Should Be Reviewed

Refco's primary argument in opposition to the Liquidator's petition for certiorari is the contention that a case of this kind is unlikely to arise again because the Liquidator[1] is trying to obtain "turnover of property known to belong to someone else". Refco Br. at 7. But Refco is plain wrong when it asserts that the disputed property "belongs" to it. The disputed property consists of Mebco's bank account at Swiss Bank Corporation in New York. Contrary to the misleading impression created by Refco's brief, in addition to the monies paid into Mebco's account by Refco pursuant to various currency exchange agreements between Refco and Mebco, the account *also* contains millions of dollars paid in by others. All these funds have been commingled together, as is typical of any debtor's bank account. Thus, the "fund" which Refco repeatedly asserts "belongs" to it is in reality a bank account maintained by Mebco—clearly property of the foreign debtor.

As for the specific property interest alleged by Refco, Refco is asserting that as a result of Mebco's failure to perform certain currency exchange agreements entered into with Mebco before it was placed into liquidation, Refco is entitled to reclaim $5.3 million[2] of the monies in the account under the Uniform Commercial Code and have a constructive trust imposed on the remaining $5.7 million under state law. But the fact that Refco has formulated various legal theories which, if proved, would entitle it to obtain a judgment against Mebco, does not mean that the property "belongs" to Refco. The dis-

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1 The Liquidator has no subsidiaries. Its parent companies are listed in the Petition for Certiorari at ii.

2 While the Second Circuit understood the reclamation amount to be $6.9 million, the actual amount delivered by Refco to Mebco's bank account in New York for which there was no performance by Mebco was $5.3 million, as Refco acknowledged and as the district court held on July 30, 1992.

puted fund will "belong" to Refco only if the § 304 petition is denied, Refco proceeds to judgment in the breach of contract case it initiated in New York after the Swiss insolvency proceedings had begun and levies against Mebco's account pursuant to its ex parte attachment. Until that time, the funds in Mebco's New York bank account are part of the property being administered by the Liquidator for the benefit of all Mebco's creditors in Switzerland. In short, Refco's so-called ownership interest is simply the claim that it is owed money as a result of Mebco's insolvency and wants to be paid from Mebco's assets, a claim which could be made by all of Mebco's creditors.

Refco's claim that the property "belongs" to it is not only wrong as a matter of fact, it begs the question presented to this Court: does § 304 require that an American creditor's claim to an asset being administered in a foreign insolvency proceeding be adjudicated *before* that property may be turned over to a lawfully-appointed foreign representative under § 304? As set forth in the Liquidator's petition, § 304 is intended to be a forum selection device. Where, as here, an appellate court has determined that the bankruptcy court correctly found that the jurisdictional requirements of the statute have been met and properly balanced the 304(c) factors, all inquiry should be at an end. In holding that the bankruptcy court was required to go further and actually adjudicate the state law claims raised by a local creditor before granting turnover to a foreign representative, the Second Circuit undercut the whole reason for § 304—to have transnational bankruptcy proceedings administered in a single forum so that the claims of all creditors, foreign and domestic, can be equitably determined.

While Refco asserts that it is not an ordinary creditor seeking to take advantage of an ex parte attachment against a foreign debtor's American assets, it is impossible to describe what Refco has done any other way. The fund is not Refco's property; it is a bank account belonging to a foreign debtor against which any number of creditors could assert similar claims. Indeed, two other Mebco creditors have already attempted to

assert claims to part of the same fund which Refco seeks to seize. Under § 304, all these claims should be pursued in Switzerland so that equality of distribution, one of the prime tenets of our bankruptcy code, can be achieved.

This case presents precisely the situation § 304 was meant to address. A bank account belonging to a foreign debtor is just the kind of property one would expect a foreign debtor to have in the United States, especially if the foreign debtor is a bank. It is also the kind of property one would expect to be subject to distribution abroad. Indeed, far from being a unique situation, this case presents the exact scenario that caused Congress to enact § 304 in the first place. The impetus for § 304 came from the problems caused by the insolvencies of three foreign banks in the 1970's. Charles D. Booth, *Recognition of Foreign Bankruptcies: An Analysis and Critique of the Inconsistent Approaches of United States Courts*, The American Bankruptcy Law Journal 135, 143-46 (1992). Because this case should have been a routine application under §304, the precedent it sets will have grave consequences for the future use of § 304.

Refco's arguments about the "plain meaning" of Bankruptcy Code § 304 only underscore the need for this Court's review. Invoking the rule that, if possible, a statute must be construed to give every word "operative effect," Refco Br. at 11 (quoting *United States v. Nordic Village, Inc.*, 503 U.S. ____, 112 S. Ct. 1011, 117 L.Ed. 2d 181 (1992)), Refco relies on that part of the Second Circuit's opinion which quotes § 304 by deleting the term "such" estate and replacing the term "the" estate:

> The power of the court extends to "property of *[the]* estate." . . . It is unsatisfactory to say that the property should first be turned over, because it is the ascertainment that property is "of *[the]* estate" under local law that defines the extent of the court's power to issue the turnover order.

961 F.2d 341, 349 (emphasis added); *see also* Refco Br. at 9-10. The meaning of the statute can hardly be "plain" if a court

must change its terms to apply it: Erasing a term does not give it "operative effect".[3]

Refco's reliance on the Second Circuit's view that property "of such estate," *see* § 304(b)(2), cannot be property "involved in" the foreign proceeding, *see* § 304(b)(1), because 304(b)(2) and 304(b)(1) " 'perform different functions,' " Refco Br. at 12, is also inconsistent with the principle that the statute should be read as Congress wrote it. Section 304(b)(1), the injunctive arm of the statute, does not, in terms, limit the injunctive relief available to a foreign representative to a preliminary injunction. All the statute says is that the court may "enjoin the commencement or continuation of" certain actions. *See also* Charles D. Booth, *Recognition of Foreign Bankruptcies: An Analysis and Critique of the Inconsistent Approaches of United States Courts*, The American Bankruptcy Law Journal 135, 161 (1992) ("Section 304(b)(1) authorizes the bankruptcy court to enter interim or permanent relief"). Thus, on the Second Circuit's view, a bankruptcy court can permanently enjoin an action against funds involved in the foreign proceeding without a preliminary determination under state law that the money belongs to the foreign debtor but refuse to turn over the funds if it determines that the American creditor has a state-law right (rendered unenforceable by the injunction) to the funds.

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3 Nor does Refco's contention that the Second Circuit only invoked Bankruptcy Code § 541 as an analogy, rather than to define conclusively the property that could be turned over under § 304, obviate this Court's review. *See* Refco Br. at 10. The Second Circuit's opinion calls for evaluation of property interests under § 541 in § 304 proceedings. Indeed, Judge Blackshear, the Bankruptcy Judge presiding in this and other § 304 proceedings, apparently understood the Second Circuit's opinion this way. *See In re Laurencia Jaen Ocana*, Case No. 91-B-15233 (CB), Order Granting Preliminary Injunction under Section 304 in Case Ancillary to a Foreign Proceeding (Bankr. S.D.N.Y. June 8, 1992) (granting preliminary injunction in part because "Petitioner has met his burden of showing a probability of success on the merits under Bankruptcy Code Sections 304 and 541"). Only this Court's resolution of whether property rights under American law must be adjudicated in a § 304 proceeding will end confusion concerning the applicability of § 541 to § 304 petitions.

Refco also misreads that part of § 304(b) which states that a "party in interest" may "timely controvert the petition" and contemplating a "trial". Refco assumes that the basis upon which controversion is appropriate is ownership under American law of the assets subject to the 304 petition. Refco again begs the fundamental question whether a threshold determination of local creditors' claims under state law is necessary to resolve a 304 petition: The statute does not *say* that a bankruptcy court must hold a trial to decide who owns the local assets under American law, and the question presented to this Court is whether, despite the absence of an express requirement, a bankruptcy court must nevertheless hold a trial on that issue. Section 304's underlying purpose to avoid piecemeal distribution of assets in the United States dictates that the bankruptcy court adjudicate only the jurisdictional requirements of the statute and the relevant 304(c) factors. There is nothing in the statute's reference to a trial which even remotely suggests that the bankruptcy court must also adjudicate claims based on local law before ordering turnover. As two commentators put it:

> The statute contemplates final relief unless the petition is controverted or after resolution "at trial." "Controversion" is not defined. It has been accorded its dictionary meaning, deny or take issue with. The concept of "controversion" first involves the petitioner's standing. If there is a standing deficiency, the case should be dismissed. After standing is resolved (usually on documents), the court must consider whether the foreign proceeding qualifies for American judicial recognition and assistance under Section 304(c). Both standing and qualification may be challenged by a party at interest [sic]—the foreign debtor or the owners of or claimants to the local res. . . . A final Section 304 judgment should reserve all substantive issues to the foreign forum and its law once the standing and qualification standards have been met.

Brian J. Gallagher and John Hartje, *The Effectiveness of § 304 in Achieving Efficient and Economic Equity in Transnational*

Insolvency, 1983 Annual Survey of Bankruptcy Law 1, 8, 15 (1983)(footnotes omitted).

Finally, Refco attempts to portray the Liquidator's construction of § 304 as "absurd" by selectively quoting from the Liquidator's response to a question from the Second Circuit at oral argument. Refco Br. at 14. The panel asked counsel for the Liquidator whether stolen property could be subject to a turnover order. Counsel responded that if such property in question was part of the property being administered in Switzerland, and if the bankruptcy court determined that under those circumstances—quite different from those present here—the 304(c) factors still weighed in favor of ancillary relief, the bankruptcy court would have the power under 304 to order turnover. The Liquidator's answer was clearly correct. A determination that the 304(c) factors weigh in favor of relief is a finding that the foreign proceeding is fundamentally fair and equitable and should be afforded deference by our courts. Where such a finding has been made, it is inconsistent with the principle of comity and the plain language of 304 to deny turnover out of concern for the specific recovery a particular local creditor (the victim of theft, in the hypothetical posed by the Second Circuit) would receive abroad on its claim.

Commentators have long espoused the view of § 304 taken by the bankruptcy court and the district court in this action. Indeed, just prior to the Second Circuit's decision in this matter, Professor Charles D. Booth concluded an exhaustive treatment of § 304 with the apt observation that:

> It is time for U.S. bankruptcy judges, lawyers, and creditors to reject the territoriality approach and acknowledge that the U.S. does not have a monopoly over fair bankruptcy procedures. Many other countries have bankruptcy laws and procedures that, although differing in some respects from U.S. laws and procedures (such as by setting forth different priority rules or by requiring less creditor participation), are based on similar principles (the most important of which is the principle of equality of distribution), are just and fair in their overall treatment of

debtors and creditors, and are deserving of recognition by U.S. courts.

What John Lowell wrote a hundred years ago is just as appropriate today:

> It is obvious that, in the present state of commerce and of communication, it would be better in nine cases out of ten that all settlements of insolvent debtors with their creditors should be made in a single proceeding, and generally at a single place; better for the creditors, who would *thus share alike*, and better for the debtor, because all his creditors would be equally bound by his discharge.

Back in the 1880's, Lowell was forced to admit that "[i]t is not so easy to see how this result is to be reached in actual practice." Today, however, with the existence of § 304, not only has this result been reached in individual cases, but it is now possible to make this result the norm in cross-border insolvencies involving assets in the United States.

> . . . . Given the recent worldwide recession, many more § 304 cases will likely arise in the near future. The treatment by U.S. courts of these cases may well determine whether § 304 will survive in its present form or whether amendments will be necessary to achieve the worthwhile goal of increased cooperation in transnational insolvencies.

Charles D. Booth, *Recognition of Foreign Bankruptcies: An Analysis and Critique of the Inconsistent Approaches of United States Courts*, The American Bankruptcy Law Journal 135, 230, 232 (1992)(footnotes omitted) (quoting John Lowell, *Conflict of Laws as Applied to Assignments for Creditors*, 1 Harvard Law Review 259, 264 (1888) (emphasis added)); *See also* Brian J. Gallagher and John Hartje, *The Effectiveness of § 304 in Achieving Efficient and Economic Equity in Transnational Insolvency*, 1983 Annual Survey of Bankruptcy Law 1, 19 (1983) ("The proper role of a Section 304 case is the extension

of American equitable power to a foreign court in order to preserve the principle of equality economically achieved. . . . The only distribution expressly contemplated by the statute is a pourover of assets to a foreign court for eventual distribution there under qualifying foreign law").

II. This Case Is Ripe for Review

Since the Second Circuit's opinion, the lower courts in this matter have construed the Second Circuit to have mandated that judgment be entered for Refco on its claim for reclamation under the New York Uniform Commercial Code without a hearing. Specifically, on May 19, 1992, the bankruptcy court vacated the injunction it had imposed earlier on Refco's continuation of the action Refco had originally commenced in the district court (*Refco F/X Associates, Inc.* v. *Mebco Bank, S.A.*, 89 Civ. 3071 (WK)) with respect to Refco's reclamation claim, leaving Refco free to pursue its reclamation claim in district court. Refco then moved for summary judgment in the district court which was granted on collateral estoppel grounds. However, the district court has stayed execution of the judgment pending this Court's resolution of the petition for certiorari. Thus, as to $5.3 million (the amount the district court determined was reclaimable) of the funds in the account, the instant petition is clearly not interlocutory. Indeed, Refco has made no attempt to controvert the Liquidator's showing that this petition is ripe for review. Accordingly, there is no dispute that questions presented by this petition are in the proper posture to be reviewed by this Court.

CONCLUSION

The petition for certiorari should be granted.

Respectfully submitted,

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